

General Information Letter: Foreign tax credit is not allowed for taxes paid to another state on compensation "paid in this State" under IITA Section 304(a)(2)(B).

January 25, 2005

Dear:

This is in response to your letter dated January 4, 2005, in which you question the computation of the credit allowed to your clients for taxes paid to other states. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

In your letter you have stated the following:

My clients Mr. & Mrs. Z SS# XXX-XX-XXXX received a LTR-402 Error Notice Response denying them credit for taxes paid to other states. My client Mr. Z is a full year resident in Illinois and works for COMPANY. He is a consultant and works in multiple states. The W2 shows IL taxable wages equal to Federal taxable wages and additional W2s issued to show the amount of federally taxed wages that were earned in other states. Mr. Z's taxable wages for 2003 were \$103,868 (\$38,419 in the state of Illinois, \$40,675 in Pennsylvania and \$24,774 in Georgia). His W2 reflects Federal wages of \$103,868, Illinois wages of \$103,868, Pennsylvania wages of \$40,675 and Georgia wages of \$24,774.

The employer states that, since the employee is a resident of Illinois, his entire earnings no matter which state it was earned is taxable and a request for credit for taxes paid to other states, but the W2 should reflect the wages that are earned in Illinois should be reported as Illinois wages in the W2 and not the total wages earned. As I cannot find any publication to this fact, I am not able to convince COMPANY, given that this company is one of the fortune 500 companies.

I do not think my client should be double taxed. Further, I think my client is being singled out, since every employee of COMPANY has gotten a similar W2 for every year they worked and have received a credit for taxes paid for every other jurisdiction.

## **Response**

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601) provides:

The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base

income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. For purposes of this subsection, *no compensation received by a resident which qualifies as compensation paid in this State as determined under Section 304(a)(2)(B) shall be considered income subject to tax by another state or states.* (emphasis added)

Section 304(a)(2)(B) of the Illinois Income Tax Act (35 ILCS 5/304) provides:

Compensation is paid in this State if:

- (i) The individual's service is performed entirely within this State;
- (ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or
- (iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

Your letter does not state the facts necessary to make a determination of whether your client's compensation was "paid in this State" under this provision. However, it is frequently the case that a consultant who resides in Illinois has his or her base of operations in Illinois, so that the all of the consultant's compensation is "paid in this State" under Section 304(a)(2)(B)(iii) even when the consultant works outside the State a considerable amount of time. Further, under Section 701(a)(1) of the Illinois Income Tax Act (35 ILCS 5/701), an employer is required to withhold Illinois income tax from an employee only if the wages are "paid in this State" under Section 304(a)(2)(B). This principle is explained in the Booklet IL-700, Illinois Withholding Tax Guide, pages 7 through 9. The fact that COMPANY withheld Illinois income tax from 100% of your client's compensation therefore indicates that the compensation was "paid in this State," and thus does not qualify for the credit for taxes paid to other states.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton  
Deputy General Counsel – Income Tax